

Tax e-Alert

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Tax Relief For Error Or Mistake In Tax Returns

It is quite common for taxpayers to commit an error or make a mistake in their tax returns which may result in overpayment of taxes. In such circumstances, remedy is available under Section 131(1) of the Income Tax Act 1967 (**ITA**), which provides relief to a taxpayer who has erroneously or mistakenly overpaid on taxes. However, this relief is subject to several conditions which need to be satisfied in terms of procedural and substantive law.

Recently, our Tax, SST & Customs partners succeeded in seeking tax relief for the income tax paid on subsidies received from the government.

Background Facts

The taxpayer is in the business of providing plantation services and related activities where, among other things, it produces paddy seedlings for sale. In the course of its business, the taxpayer received subsidies amounting to millions of ringgit from the Ministry of Agriculture and Agro-Based Industry (**Ministry**). In submitting its tax returns for a period of about seven years, the taxpayer had mistakenly treated the subsidies as part of its business income and subjected the subsidies to income tax.

Upon discovering that the Income Tax (Exemption) (No 22) Order 2006 (**Exemption Order**) exempts government subsidies from income tax, the taxpayer sought legal representation, where we immediately submitted an application for relief for error or mistake to the Director General of Inland Revenue (**DGIR**). Among other things, the material part of the Exemption Order reads:

“The Minister exempts —

- (a) any person from the payment of income tax in respect of income relating to the allocations given by the Federal Government or the State Government in the form of grant or subsidy”.

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The DGIR, however, rejected the taxpayer's application on the basis that the subsidies formed part of the taxpayer's business income. According to the DGIR, the subsidies were granted to mitigate the taxpayer's losses arising from the government's request for the taxpayer's products to be sold below market price.

Issues

Before the Special Commissioners of Income Tax (**SCIT**), the issues were whether:

- The subsidies received by the taxpayer from the Ministry are exempted from income tax by virtue of the Exemption Order;
- The taxpayer may apply for relief under Section 131(1) to claim the tax exemption granted via the Exemption Order; and
- The DGIR has any legal basis to reject the taxpayer's application for relief under Section 131(1).

Taxpayer's Position

The taxpayer contended that the Exemption Order clearly exempts any person from the payment of income tax in respect of a grant or subsidy given by the Federal or State Government for the following reasons:

- The Exemption Order covers the years of assessment in dispute during which the taxpayer had made the mistake of not claiming tax relief.
- It was not disputed that the taxpayer had indeed received the subsidies from the Ministry which forms a part of the government.
- The taxpayer did not make any deduction or claim any allowance under the ITA or the Promotion of Investments Act 1986.

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‘Error or Mistake’

As the term “error or mistake” is not defined in the ITA, the taxpayer relied on the ordinary legal meaning, where mistake is defined in *Black’s Law Dictionary* as:

“Some unintentional act, omission or error arising from **ignorance**, surprise, imposition or **misplaced confidence**. A state of mind not in accord with reality. A mistake exists when a person, under some erroneous conviction of law or fact, does, or omits to do, some act which, but for the erroneous conviction, he would not have done or omitted. It may arise either from unconsciousness, ignorance, forgetfulness, imposition or misplaced confidence.”

The taxpayer argued that it had committed an error when filing its tax returns by inadvertently subjecting the subsidies to income tax. This was because neither the taxpayer nor its tax agent was aware of the Exemption Order at the material time. The taxpayer was under misplaced confidence that such Exemption Order did not exist and had relied on its then tax agent to manage its tax affairs. On this erroneous conviction of law, the taxpayer did not claim the tax exemption and erroneously subjected the subsidies received from the Federal Government through the Ministry to income tax.

The wordings of the Exemption Order are clear that any subsidy received by any person from the Federal Government is exempted from tax. The law in respect of interpreting income tax provisions is settled whereby, as a general rule, one must look merely at what is clearly said in a taxing statute. The taxpayer further highlighted that even if the DGIR were to contend that the wordings of the Exemption Order were ambiguous, our courts have taken the position that if there is any doubt, then it must be resolved in the taxpayer’s favour.

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Section 131(2) of the ITA imposes a statutory duty on the DGIR to “*inquire into the matter*” while Section 131(3) requires that the DGIR “*shall have regard to all the relevant circumstances of the case*”. These provisions impose an obligation on the DGIR to consider each case on its own merits. As such, if the DGIR acts without applying his mind to the case before the DGIR, then the action or decision that he takes will be bad because he has not exercised his discretion.

In the present matter, the taxpayer submitted that the following facts clearly established that the DGIR had failed to inquire into the matter and consider all the relevant facts:

- The taxpayer had no knowledge of the tax exemption available on the subsidies under the Exemption Order until this was brought to its attention.
- Once the taxpayer became aware of the Exemption Order, it promptly made the application for relief.
- The DGIR failed to have regard to the relevant circumstance that the taxpayer only knew of the Exemption Order much later.
- Any prudent and reasonable taxpayer would want to claim the most favourable tax relief available, and a taxpayer may mitigate his tax incidence by utilising the tax relief schemes granted by Parliament.

Prior to the hearing of this case before the SCIT, our tax lawyers had won a landmark tax case involving a similar issue to the present matter before the Court of Appeal. The Court of Appeal had ruled that the Exemption Order exempts subsidies received from the Ministry from income tax. Subsequent to the decision of the Court of Appeal, the DGIR agreed to allow the taxpayer’s appeal and entered into a settlement agreement before the SCIT to return the taxes paid by the taxpayer on the subsidies received.

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Our Comments

Section 131, which regulates relief for error or mistake, requires the DGIR to consider each case on its own merits. He must exercise discretion by inquiring into the matter and having regard to all the relevant circumstances of the case. Having said that, taxpayers must take note that their application is subject to Section 131(4) of the ITA, under which the DGIR is permitted not to allow any error or mistake made as a result of a general prevailing practice.

Essentially, in making an application for relief under Section 131(1), a taxpayer must show that he had:

- Paid excessive tax by reason of error or mistake;
- Filed the application for relief within five years upon filing the tax return; and
- Made the application in writing.

In this regard, taxpayers are advised to review their tax treatments frequently and keep abreast of the various tax exemption orders issued by the government. This is essential to ensure that they receive the optimum tax advantage in the manner prescribed by the law.

If you think there has been an error or mistake in respect of your tax treatment, please contact our partners from the Tax, SST & Customs Practice, **Datuk D P Naban** or **S Saravana Kumar**, at tax@lh-ag.com

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